

DEPARTMENT OF TAXES

STATE OF VERMONT



BIENNIAL REPORT
1999-2000

MISSION STATEMENT

The mission of the Department of Taxes is to collect the proper amount of tax revenue in a timely and efficient manner to pay for the goods and services people receive from State government; administer benefit programs through the most efficient means possible; and serve local governments by striving to improve local property tax assessment practices; and to assist and service taxpayers, legislators and all others by any means possible.

TABLE OF CONTENTS

Commissioner's Letter	1
Organization Chart	2
Department Highlights	
Administration and RAARP Division	3
Compliance Division	3
Information Systems Division	5
Property Valuation and Review	6
Taxpayer Services	10
Active Trust Tax Accounts	11
Returns Examined	11
Highlights of Tax Legislation	12
Tax Litigation	23
Formal Rulings	32
Technical Bulletins	36
Interest Rates	38
Description of Taxes and Tax Programs	39
Sales and Use Tax Statistics (Fiscal Year Summary by County)	46
Meals and Rooms Statistics (Fiscal Year Summary by County)	46
FY1999 Meals and Rooms Statistics (Summary by County)	47
FY2000 Meals and Rooms Statistics (Summary by County)	47
Fiscal Year Comparison of Receipts	48
What a 1¢ / 1% Increase in Certain Taxes Would Raise	49
1998 Personal Income Tax Return Statistics	
Income Class, Marital Status, Credits	50
Income, Tax, Tax-Offsets (Credits)	51
Homeowner Renter Rebate by Income Class	52
Homestead Property Tax Distribution	53
1999 Personal Income Tax Return Statistics	
Income Class, Marital Status, Credits	54
Income, Tax, Tax-Offsets (Credits)	55
School Property Tax Reduction Report	56
Homeowner Rebate Report	57
Renter Rebate Report	57
Tax Receipts Fiscal Year Historical Summary	58
Historical Summary of Vermont Property Tax Rebates	76
Commissioners of Taxes	78
Key Personnel	79

January 15, 2001

General Assembly of the State of Vermont
The State House
Montpelier, VT 05633-5301

Members of the General Assembly:

I am pleased to present the Biennial Report of the Commissioner of Taxes for 1999 and 2000, as required by 32 V.S.A. § 3101(b).

The Department is continuing to work on development and implementation of the Vermont Integrated Revenue Collecting System (VIRCS). Business trust taxes (withholding, sales and use, and meals and rooms) were converted to the new computing environment in late 1998. That system is now operating well and the Department is ready to transfer personal income taxes to the new system in late February 2001.

Implementation of the income tax phase of VIRCS has taken intensive preparation and significant resources. We anticipate a successful conversion, but any system change of this magnitude involves challenges. The new system, once implemented, will improve customer relations, collections and administration.

In 2001, for the first time, the Department is offering electronic filing to most of our taxpayers. Businesses may file their trust taxes on-line through a partnership with NationTax. Filers who use preparers with approved software may file electronically through Fed/State e-file. Vermont's own internet filing alternative – V File – will be available on February 1, 2001, for income tax filers who have access to a computer and who were full-time Vermont residents for all of 2000.

Also for the first time, in 2001, the Department will be offering a toll-free menu-driven telephone number for refund tracking and for callers to find out the amount of last year's prebate and when this year's prebate will be mailed.

In 1999 and 2000, the Division of Property Valuation and Review (PVR) implemented most of the changes recommended by the Almy Report which was issued in 1999. For the most recent equalization study, PVR introduced more sophisticated statistics resulting in greater reliability in the study report.

Our efforts to collect tax revenue in a timely and efficient manner are clearly enhanced by the support the Department receives from the administrative and legislative branches of government.

Respectfully submitted,

Janet Ancel
Commissioner of Taxes

Organization chart

DEPARTMENT HIGHLIGHTS

ADMINISTRATION and RAARP DIVISION

This Division includes all the people responsible for overall Department leadership, policy-making, budget and personnel functions, plus revenue accounting and returns processing (RAARP).

The Administration section includes the Commissioner, Deputy Commissioner, General Counsel, Policy Analysts, Business Manager and their immediate staff; a total of 16 permanent, full-time employees. This section has overall management control of the entire Tax Department. The Administrative Division responds to all tax policy inquiries from the Governor and Legislature, issues rulings and technical bulletins to implement tax legislation, conducts tax appeal hearings and represents the Department in any civil or criminal litigation. This Division also provides budget preparation and fiscal management services, personnel administration and payroll processing, procurement of all goods and services (including contract administration) and inventory control for all office supplies, furniture, equipment and tax forms.

The RAARP section consists of 21 permanent, full-time employees and 35 tax-season temporaries. This Division is responsible for all revenue accounting and returns processing needs of the Department. Those duties include: receipt, opening and routing of all incoming mail; tax return validation and control; data capture via traditional key entry or scanning/imaging; daily bank deposits and related cash management functions including credit card payments and electronic funds transfers, GAAP/FMIS reporting, and bank account/general ledger reconciliations. RAARP also encompasses all mailroom/stockroom operations, including processing all out-going mail, i.e., preparation and distribution of tax forms, refund checks, delinquency notices/bills and any special mailings to taxpayers. It also includes coordinating all aspects of the "substitute forms program", which is a significantly expanded responsibility now that a majority of our returns processing and tax remittance is performed with imaging/scanning equipment.

COMPLIANCE DIVISION

Compliance is the enforcement division of the Department of Taxes. In addition to standard audit selection and collection activity, our goal for the next two years is to continue to effectively use the Department's new computer system as a resource. The data gathering and reporting functions

of the system will allow for better audit selections and more effective tracking of collections cases through the use of electronic work lists in lieu of paper data.

Audit results for the biennium. During FY1999, 24 audit positions resulted in the processing of 1,128 cases and assessments of \$6.6 million dollars. In FY2000, 24 audit positions resulted in the processing of 1,259 cases and assessments of \$5.6 million dollars. Audit cases include assessments, refunds, "no change" on non-assessed audits, and examinations of refund requests which often result in the reduction of a refund.

Audit assessments include all taxes administered by the Department but the predominant tax types examined were: sales and use, meals and rooms and individual income taxes (primarily from non-filers of these taxes).

With the support of the Commissioner of Taxes and the assistance of the Attorney General's office, the Department has a full time investigator and an assistant attorney general who works part time on criminal tax investigations. This group actively pursues income tax non-filers and those businesses who collect trust taxes and fail to file and/or remit these taxes to the State. We expect a number of prosecutions in the next biennium as well. During FY99, four prosecutions resulted in restitution and court fines of \$55,000. During FY00 we had three prosecutions with convictions again for a total of \$55,000. Publicity surrounding the convictions has resulted in numerous non-filers coming forward to file and remit taxes due.

Collection results for the biennium. Approximately 14 full-time positions were devoted to the collection of delinquent taxes, including two field collectors who meet with taxpayers at their place of business. The Compliance Division maintains four half-time positions to conveniently contact taxpayers with income tax bills during the evening hours of 4:00 to 8:00 p.m.

The total amount of tax accounts receivable has increased to \$79 million dollars. This is partially explained by the increase in estimated billings for the trust taxes. Delinquent taxes (which include penalties and fees) collected were \$18.2 million dollars in FY1999 and \$12 million dollars in FY2000.

The Compliance Division continues to place accounts with private collection agencies, as authorized by 16 V.S.A. § 3109. In FY1999 these agencies collected \$1.1 million and \$558,000 in FY2000. Compliance will soon be sending more accounts to the agencies.

In addition to tax collection, the Department offsets income tax refunds for other State agencies with debts and the IRS. In each fiscal year, approximately \$1.5 million was sent to agencies participating in the program.

INFORMATION SYSTEMS DIVISION

Information Systems manages automated information processing for the Vermont Department of Taxes. In this role, we support not only all the Department employees, but over 500,000 taxpayers as well as all the municipalities in the State. The unit is staffed by seventeen technical positions and two support positions. Our goal is to provide automated solutions that enable our Department employees to meet the needs of the taxpayers of Vermont quickly, effectively and correctly.

During 1999 and 2000, much of the Division's resources were focused on the enhancement of the Vermont Integrated Revenue Collection System (VIRCS). The business trust taxes (sales and use, meals and rooms, and withholding) were put into production in late 1998. Many enhancements have been made in the last two years to improve processing of those taxes. Personal income tax and school property tax have been under development for implementation in early 2001.

As part of the 2001 income filing initiative, Vermont will be participating in the Fed/State E-file program for the first time. This will allow Vermont taxpayers who use tax preparers to have both their Federal and State returns processed electronically. In addition, Vermont will offer taxpayers who prepare their own returns the option of filing over the internet via a free, web-based application. While both these programs will be limited in the types of forms that can be filed, this is an exciting step forward into the electronic age. Approximately 251,200 taxpayers qualify to participate in these programs.

Our Electronic Funds Transfer (EFT) program has been in production for withholding taxes for several years. The original EFT credit option was expanded to permit taxpayers to file via EFT debit transactions.

In addition, in September 2000, we offered our business tax filers the opportunity to use the internet to meet their filing obligations by working with a third-party filing service, NationTax. In the coming months we hope to enlarge the pool of third-party filing services in order to allow our taxpayers the widest selection possible.

We continue to enhance our imaging and scanning applications in support of the business trust taxes. In the spring of 2001, we will begin to image and scan the personal income tax and school property tax forms for the first time. The goal of this application remains reducing the time needed to transfer data from a paper return to the computer system with a high degree of accuracy and a minimum of tax employee intervention.

Another major initiative for the Division in 1999-2000 has centered on supporting statewide property tax initiative. The Division provides support to towns and municipalities throughout the State in the use of the CAPTAP II software which towns may choose to use for their listing and tax billing needs.

During 1999, the Division expended many person hours in ensuring uninterrupted service to the Department employees and the taxpayers they serve by making certain that every piece of hardware and software was up to the challenge of functioning in the new millennium. This effort was commonly referred to as Y2K. The Division successfully met this challenge. Y2K came and went without any service disruptions.

As we go forward into 2001 and 2002, the resources of the Division will be geared toward the continued development and implementation of the various phases of VIRCS as well as the continued support of needs of towns as we meet the legislative mandates that arise on an annual basis.

PROPERTY VALUATION AND REVIEW

Property Valuation and Review (PVR) provides administrative support for Vermont's property tax system as well as fills roles in the development and execution of State property tax policies and the administration of several State property tax related programs. All major functions assigned to the Division involve taxes and programs that are primarily administered by municipal governments, hence PVR works extensively with local governments in the performance of its duties.

Specific programs and functions include a number of major programs that are detailed below. In addition, the Division frequently serves several other functions such as the appraisal of State owned buildings and land and provides staffing for both Executive and Legislative studies and commissions.

Equalization Study. Annually, the Division conducts a study that results in estimates of the fair market value of all taxable property in all Vermont

school districts. The major product of the study is the Equalized Education Grand List (EEGL) which is an estimate of the total fair market value of property that is taxable for school purposes. The EEGL is used by the State in determining State Education and Local Share property tax liabilities for all school districts. The estimation of fair market values is based on the ratios that result from comparing arm's length sales to the corresponding values found on towns' grand lists. The grand list values are then adjusted to reflect the deviation between the market sales and grand list values. Sales verification to determine the arm's length status of sales involves considerable input from local appraisal officials but the final determination of validity rests with the Division. The Division has conducted Equalization Studies since the early 1970s. We recently undertook an extensive review of the methods and procedures used in the Study including an independent evaluation. As a result, extensive changes were implemented for the 1999 and 2000 Studies. The major changes involve improvements in the statistics used in the Study and the review of the results that are aimed at increasing the reliability of the fair market value estimates.

Current Use. The Current Use, or the Use Value Appraisal program, allows enrolled property owners with eligible land and buildings to have their property taxes assessed on the productive value of their property, as opposed to its fair market value (which is the legal standard for assessment of all other real property). Enrolled owners agree to keep this property in productive agriculture and forest use. Owners pay property tax based on separate agriculture and forest productive values that are the same for all enrolled land statewide. Agriculture enrollees can also have qualified farm buildings taxed at 30% of fair market value. All enrolled property is assessed at its respective use value and this reduction in value is reflected in PVR's equalization study which results in lower education property taxes for impacted municipalities. The Division administers a "hold harmless" program that reimburses municipalities for the revenue reduction associated with municipal taxes resulting from this program. The current use program also administers the Land Use Change Tax. This is a tax imposed on owners of enrolled land who develop their property or wish to voluntarily discharge the lien by payment of this tax. The tax is computed at 20 percent of the full fair market value of the developed land and is payable to municipalities in which the property is located.

Vermont Mapping Program. The Vermont Mapping program produces and distributes orthophotographic maps, both analog and digital, for the State. Analog exists statewide in two vintages. Digital orthophotography has been completed in 12 of the 14 counties with production in Windham and Bennington counties underway. The sale and distribution of the digital products has surpassed expectations. As of November 2000, we have sold

1,509 CD-ROMS of the digital orthophotographs compared to 513 for the same period last year. With digital orthophotography completed statewide in 2001, we need to update specifications and start to update the digital images, as the images for Rutland and Windsor counties will be 10 years old in 2004. The digital format enhances the accuracy of the product and allows for new uses in concert with evolving technologies. For example, the digital elevation model allows contours to be generated that can be used with property maps and digital orthophotography to create a comprehensive view of property. This would allow appraisal officials to more accurately value vacant land from a remote site thus enhancing both tax equity and operational efficiency. The maps are used heavily by an array of public and private sector organizations to aid in their planning and administrative functions.

Computer Assisted Property Tax Administration Program (CAPTAP).

To assist local officials and enhance the standardization of assessment practices within the State, PVR has traditionally supported software for determining property values and administering the property tax. The Division supports a software program called CAPTAP-II. While the use of the CAPTAP software is elective, it is the Division's goal to have the majority of municipalities choose this software program. The Tax Department contracts with selected software developers to produce the programs and provides direct support to municipalities for software use. Currently, about 150 Vermont municipalities are using a version of CAPTAP software.

Property Tax Appeals. PVR fulfills several quasi-judicial functions with regard to property taxation. The most important involves appeals of property values as set by municipalities. Attached to PVR are the "State Appraisers" who hear assessment appeals from the local level. The State Appraisers serve as independent hearing officers and set values based on the evidence resulting from appeals hearings. Typically the State Appraisers hear about 400 appeals annually. Aside from property assessment appeals, the Director of PVR hears appeals related to the Current Use program and the results of the Equalization Study.

Technical Support of the Property Tax System. The Division has eight District Advisors who offer direct support to local assessment officials (listers). The Advisors are regionally located to offer legal and technical advice to listers throughout the State. The expertise available from the Advisors is particularly important as many local officials have a limited background in property assessment and the availability of support both enhances the reliability of assessments and results in greater standardization of assessment practices throughout the State. The Division provides support

to local officials through a Department attorney and other centrally located staff with expertise in property assessment and property tax administration.

State real estate taxes (Real Estate Withholding, Property Transfer and Lands Gains). In order to centralize all taxes related to real estate in one part of the Department, the real estate withholding (REW), property transfer and land gains taxes have been transferred to the PVR Division. The REW program is not a tax per se, but a 2.5 percent withholding of the consideration involved in a transfer of real property interests by entities that are not resident to Vermont. The withholding is required to insure that the appropriate amount of taxes on any gain resulting from the transfer is paid when the seller files a Vermont income tax return. The property transfer tax is an amount due from a buyer of Vermont real property and is based on a percentage of the sale price. Typically, the tax rate is 1.25 percent of the total sales price, though for property that is to be used as a principal residence there is a split rate with .5 percent applied to the first \$100,000 and 1.25 percent applied to the remaining value. Land gains is a tax imposed on the seller of real property held for a relatively short period and resold. Hence, the purpose of the tax is to mitigate against speculative property purchases by imposing a sliding scale rate that is higher for shorter term holdings against the gain recognized through the sale of the property. All three of these taxes have exemptions that reduce or eliminate the tax under statutorily defined circumstances.

Data collection and analysis. PVR has the statutory role of collecting and disseminating information about property taxation in Vermont. The primary data collections include property assessments from all municipalities (the grand lists and the summary of the grand lists) and property tax rates. Beyond this, the Division annually collects information about utility values, locally elected municipal officials and property sales. The Division makes this information available to local officials, State government and the public through its Annual Report. The Division also produces and distributes to municipalities a number of forms that are used in the administration of the property tax.

Payment in Lieu of Taxes (PILOT). State-owned property cannot be taxed by municipalities in Vermont. The PILOT program serves to partially compensate municipalities for the potential reduction in tax base due to the presence of State-owned buildings and land. PILOT payments are made annually and are based on a calculation that considers the value of State-owned property in a municipality and calculates the taxes that would result from those properties if they had been on the tax rolls. This calculation is based on the municipal part of the tax rate (as opposed to school taxes).

TAXPAYER SERVICES

Taxpayer Services Division administers 18 taxes, 3 licensing programs, and 2 benefit programs. The Division's mission is to provide taxpayer assistance programs, distribution of educational materials encouraging voluntary compliance with Vermont tax laws, and examination of tax document information. These activities assure the Department receives the most accurate information possible, the appropriate amount of taxes due, and that taxpayers receive notification of errors. The Division also distributes applications for the Lifeline and V-Script programs and process these application to verify income.

The Division devotes much of its activities to education and to promoting voluntary compliance. Staff respond to taxpayer questions, assist in completing tax forms, and help resolve tax problems for taxpayers. Taxpayers may receive assistance by telephoning, writing letters, sending a fax, sending an e-mail, or visiting the office. The Division also provides some on-site registration and assistance for businesses at special events such as fairs or craft shows. Taxpayers may come to the Montpelier office for help in completing their tax returns or applications. During January and April (the income tax filing season), taxpayers will find Division staff available to assist completing their income tax returns at the IRS in Burlington. The Division responds annually to approximately 150,000 telephone calls and assists 9,000 taxpayers.

The Division also conducts or participates in many workshops and seminars for taxpayers, tax preparers, or volunteer groups. These workshops and seminars are often jointly presented with the Internal Revenue Service, Small Business Administration, Community Action, University of Vermont, University of New Hampshire, and the Vermont State College extension service. For personal income tax, staff train volunteers who help citizens complete income tax returns. The Vermont Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) program which is jointly sponsored by the Department and IRS holds training sessions at ten locations throughout the State as well as at Champlain College, UVM, St. Michael's College and Vermont Law School. The Division presented at 15 workshops throughout the State during the 1999/2000 biennium.

Over the next biennium, the Division plans to increase its presence in the internet arena to make information easily accessible and at the taxpayers' convenience. More information will be placed on our web site, and we will facilitate voluntary compliance by promotion of electronic filing methods and the internet. For example, employers can file their withholding tax by electronic funds transfer. Also, a private service provider contacted the

Department for permission to file their customers' sales tax or meals and rooms tax returns by the internet service. The company met our specifications and their customers can now internet file.

The Division's goal will also be revising procedures and processing methods to continue realizing efficiencies from our new computer processing system. The next two years brings the addition of the individual income tax to this processing system in 2001.

ACTIVE TRUST TAX ACCOUNTS

	<u>Fiscal Year 1999</u>	<u>Fiscal Year 2000</u>
Sales & Use Tax		
Monthly	7,600	8,152
Quarterly	16,556	15,448
Annual	10,260	10,626
Meals & Rooms Tax		
Monthly	3,417	3,811
Quarterly	1,406	1,020
Withholding		
Monthly	5,388	5,391
Quarterly	20,702	21,060
Weekly	857	1,334

RETURNS EXAMINED

During the biennium, the Division examined the following volume of tax returns:

	<u>Tax Year 1998</u>	<u>Tax Year 1999</u>
Personal Income Tax	318,870	327,337
Homeowner/Renter Rebate	43,847	
Renter Rebates		13,254
Homeowner Rebates		28,468
School Property Tax Prebates	119,351	127,028 ¹
	<u>Fiscal Year 1999</u>	<u>Fiscal Year 2000</u>
Sales and Use Tax	157,315	160,659
Meals and Rooms Tax	40,668	40,393
Withholding Tax	140,446	168,826
Corporate/Business Entity Taxes ²	33,438	33,741
Estate & Fiduciary Tax	7,430	8,121

¹ Includes the number of homeowner rebates reviewed.

² Includes estimate voucher payments and extensions for corporations.